UNITED STATES OF AMERICA
BEFORE THE
DEPARTMENT OF ENERGY

INTERSTATE ELECTRIC TRANSMISSION SYSTEM: ELECTRIC RELIABILITY ISSUES	**DOCKET NO. _____**

COMMENTS OF BASIN ELECTRIC POWER COOPERATIVE

Basin Electric Power Cooperative ("Basin Electric") hereby submits comments in response to the Department of Energy's Notice of Inquiry as to whether it should issue a notice of proposed rulemaking relating to the imposition of mandatory electric reliability standards by the Federal Energy Regulatory Commission ("FERC"). Basin Electric believes that in the absence of legislation, the FERC does not clearly have the authority to establish mandatory reliability standards. However, the FERC can use its existing authority to significantly enhance the reliability of the bulk power transmission system. The principal way in which the FERC can enhance reliability is to stimulate the construction of additional transmission facilities, in particular, through the elimination of "license plate pricing" within RTOs and the adoption of postage stamp pricing.

I. DESCRIPTION OF BASIN ELECTRIC

Basin Electric is a consumer-owned rural electric cooperative headquartered in Bismarck, North Dakota. Basin Electric was created in 1961 to construct and operate generation facilities to provide electric power to the rural electric customers of the Western Area Power Administration ("WAPA") in WAPA's Upper Great Plains Customer Service Region and Rocky Mountain Customer Service Region that exceed the

capability of WAPA's hydroelectric facilities in these regions. Consequently Basin Electric, through its G&T cooperatives and distribution cooperatives, serves the loads of many of the same ultimate consumers that WAPA serves in those regions. Basin Electric has outstanding debt with the U.S. Department of Agriculture's Rural Utilities Service ("RUS") and therefore is not subject to the FERC's jurisdiction under the Federal Power Act. Nonetheless, all of Basin Electric's transmission facilities are included in open access transmission tariffs that are consistent with or superior to the FERC's pro forma transmission tariff issued in Order No. 888, and Basin Electric voluntarily complies with the separation of functions and other requirements of FERC's Order No. 889. [1]

Basin Electric operates electric generating power plants with a total capacity of 3,304 megawatts providing supplemental wholesale power to 117 rural electric member systems in Colorado, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Dakota and Wyoming, as well as to non-member customers. In total, the member systems serve a region of approximately 400,000 square miles.

Basin Electric also constructs transmission facilities to maintain reliable service to its customers. Basin Electric owns approximately 2,400 line-miles of electric transmission facilities, operated at voltages from 115 kV to 345 kV. Approximately 1,100 miles of these facilities are jointly owned with other utilities. The transmission

[1] Basin Electric's transmission facilities in the Eastern interconnection are included in the Integrated System Tariff that was filed by the Western Area Power Administration and accepted by the FERC in *United States Department of Energy – Western Area Power Administration,* 85 FERC ¶ 61,273 (1998), *reh'g pending.* Basin Electric's transmission facilities in the Western Interconnection are included in a transmission tariff that was submitted to the FERC in a Petition for a Declaratory Order in Docket No. NJ00 -7-000, which is currently pending.

facilities are located in both the Eastern Interconnection and the Western Interconnection. Consequently, Basin Electric operates in both the Mid-Continent Area Power Pool ("MAPP") and the Western System Coordinating Council ("WSCC").

Please contact the following persons for further information on the matters discussed herein and include their names on any official service list that is complied in these proceedings:

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II. RESPONSE TO QUESTIONS

1. IS THE EXISTING ARRANGEMENT OF VOLUNTARY COMPLIANCE WITH INDUSTRY RELIABILITY RULES SUFFICIENT TO ENSURE THE RELIABILITY OF THE BULK POWER TRANSMISSION SYSTEM?

The existing industry structure, which provides for voluntary compliance with industry reliability standards, provides adequate protection of the reliability of the bulk power transmission system. The industry has not experienced a widespread, cascading transmission outage since the creation of the North American Electric Reliability Council ("NERC"). On the contrary, the ability of the nation's bulk power transmission system to

withstand multiple contingencies has demonstrated that the existing system of voluntary compliance with reliability standards has worked well. Recent problems with respect to high energy prices and generation shortages reflect inadequate generating supplies and, to a lesser extent, inadequate transmission construction, but do not indicate a fundamental problem with the adequacy of reliability standards.

NERC and other segments of the industry that are concerned with reliability have continued to work to ensure that reliability is maintained despite the strains caused by the massive changes in the electric industry. In the years since its creation, NERC has worked hard to develop and implement comprehensive standards for the maintenance of reliability on the nation's transmission system. The regional reliability councils have implemented those standards, taking into consideration regional differences in transmission systems and practices. In recent years, the FERC has required transmission providers to file notices indicating whether they adopt NERC's Transmission Loading Relief procedures or instead adopt other procedures that are consistent with or superior to the NERC procedures. Finally as a result of the FERC's issuance of Order No. 2000, the transmission industry is moving rapidly toward the regionalization of transmission service, which has resulted in an increase in the regional focus of reliability efforts and a corresponding decrease in the practice of considering reliability issues on a utility-by-utility basis.

The events of the summer of 1999 demonstrated the effectiveness of the voluntary system of maintaining transmission reliability. On at least one occasion, a transmission owner did not comply in all respects with the NERC's standards for the maintenance of reliability on the bulk transmission system. However, that incident did

not result in transmission outages because the great majority of transmission owners complied with the reliability standards, thereby preventing a localized incident from affecting the regions transmission grid. Moreover, the electric industry's nearly universal condemnation of the inappropriate activities of those who did not comply with the reliability standards left no doubt that the industry will be vigilant to ensure that such actions will not recur.

Given the industry's successful track record with respect to maintaining the reliability of the transmission system without resort to mandatory procedures, there is no basis for concluding that the reliability of the bulk power transmission system can only be preserved through the imposition of mandatory standards. The FERC should continue to work within the existing structures to ensure that the reliability of the transmission system is maintained.

2. WHAT CAN FERC DO UNDER EXISTING AUTHORITIES TO ADDRESS RELIABILITY CONCERNS?

A. The FERC Should Eliminate License Plate Pricing.

The most effective way for the FERC to address reliability concerns is to eliminate "license plate pricing" for Regional Transmission Organizations ("RTOs"). The single biggest threat to the reliability of the nation's bulk power transmission system is the lack of new transmission investment. License plate pricing is a substantial disincentive to investment in transmission capacity. Elimination of license plate pricing will result in the construction of more transmission capacity which will in turn enhance the reliability of the bulk power transmission system.

License plate pricing of transmission is a method of pricing transmission service throughout a region based on the cost of service of the transmission facilities that are

located within a specific control area within that region. For instance, the Midwest ISO ("MISO") has proposed to charge for transmission service throughout MISO at a rate that is determined, for a load located within a control area in MISO, based on the cost of the transmission facilities located within that control area.

License plate pricing is inconsistent with regional transmission service because it results in local loads paying for transmission facilities that benefit the entire region. For instance, Basin Electric is located in an area of the country that contains substantial reserves of low-cost coal. However, the coal reserves are located far from the load centers where energy is needed, and significant transmission investment is required to move the electricity that is generated from the coal-fired generators to the load centers. The license plate pricing methodology results in Basin Electric's control area paying for the cost of the transmission investment, while the beneficiary of the cheap energy – for instance, the load center in Chicago -- pays transmission rates that do not reflect any of the cost of moving the electricity on Basin Electric's system.

The lack of relationship between the charges for transmission service, which are based on local facilities, and the benefits of transmission service, which are regional, creates a substantial disincentive to construct additional transmission facilities. The disincentive exists because the entity that owns or constructs the transmission facilities, and the customers who pay for them, do not necessarily benefit from the facilities. The disincentive to construct transmission facilities is not, of course, limited to transmission facilities in Basin Electric's control area. Any transmission owner that is a member of an RTO and that is subjected to license plate pricing is in the position of supporting and

constructing transmission facilities that benefit the region outside the control area where the facilities are located but that are paid for only by the host control area.

The disincentive to construct additional transmission facilities has substantial implications for the reliability of the bulk power transmission system. The nation's transmission system is undergoing unprecedented stresses as a result of changes in the way the grid is used. The single biggest reason behind the FERC's recent emphasis on the creation of RTOs is the perception that the regionalization of transmission service will enhance competition by making it less expensive to transmit energy longer distances. Similarly, a principal basis for the initiation of retail access is that customers will benefit from being able to choose their own electricity suppliers. A fundamental predicate of both RTOs and retail access is that the transmission system will be used to a greater extent than was previously the case to provide access to more distant generators. However, net transmission investment has not increased substantially. On the contrary NERC reports that the number of circuit miles of bulk power transmission lines is projected to grow by only 0.6% per year in the period 2000 through 2004. The disparity between the increased importance of transmission service and the lack of investment in transmission facilities has substantial implications for reliability because, as the system is pushed closer to its ultimate limits, the margin of safety declines.

The FERC has the authority under Section 205 of the Federal Power Act to require a rapid transition from license plate pricing to regional "postage stamp" pricing, in which all loads in the region pay the same price for transmission service. The Commission has for years held that Section 205 requires the pricing of transmission

service on a non-discriminatory basis.[2] The Commission also has interpreted the requirement of the Federal Power Act that rates be just and reasonable to require a nexus between cost causation and cost responsibility.[3] The Commission could easily conclude that license plate pricing is inconsistent with the requirements of the Federal Power Act that rates be just and reasonable and not unduly discriminatory. Pricing transmission service on a postage stamp basis will create a greater identity between the customers who benefit from the transmission construction and those who pay for it. It also will eliminate a significant disincentive to the construction of additional transmission facilities, which in turn will enhance reliability.

B. The Commission Should Reject the Objections to Postage Stamp Pricing.

The arguments opposing postage stamp pricing and favoring license plate pricing are not sufficient to justify the adverse impact on reliability that results from such pricing. The principal objection to postage stamp pricing is that it shifts costs from areas with high transmission costs to areas with low transmission costs. There is no question that some cost shifting will occur if postage stamp pricing is adopted and no mitigation measures are adopted. However, it is reasonable for customers to experience a shift in their transmission costs in conjunction with a fundamental change in the way in which the transmission system is used. In other words, customers who have historically experienced lower transmission costs than their neighbors who have constructed more

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[2] *E.g., American Electric Power Service Corporation*, 67 FERC ¶ 61,168 at 61,489-90 (1994); *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public ;Utilities and Transmitting Utilities,* Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,669 (May 10, 1996).

extensive transmission systems should not be permitted to retain those low costs and use the neighboring systems' transmission facilities without charge.

The objections of transmission owners and state commissions that adopting postage stamp pricing will conflict with the price caps that states have adopted in connection with retail choice have no more merit than the concerns with cost shifting. Price caps typically have been adopted as part of an agreement pursuant to which utilities are permitted to recover a portion of their stranded investment in return for agreeing to open their systems to retail competition. The price caps were typically based on the bundled costs of retail service, including transmission costs that were derived from the host utility's own transmission facilities. Utilities are concerned that if their transmission costs are changed to reflect a regional postage stamp rate, they may not be permitted to recover the increased costs from retail customers. While cost recovery is a legitimate concern, it should not control the issue of whether to adopt postage stamp rates. The FERC should not be handcuffed by State commissions that have attempted to ensure that their customers obtain all of the benefits of retail access, including one-price access to all generators in the RTO, while paying no more for transmission service than they paid for transmission on the local transmission system. In short, the FERC should require the adoption of postage stamp pricing and use Federal preemption principles to require the pass-through of the changed transmission costs to retail customers.

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[3] *New England Power Pool,* 86 FERC ¶ 61,262 at 61,966 (1999); *Seminole Elec. Coop.,* 46 FERC ¶ 61,119 at 61,470-71 (1989); *St. Michaels Utilities Commission v. FPC,* 377 F.2d 912 at 915 (4th Cir. 1967).

C. The FERC Should Take Other Steps to Stimulate Transmission Investment.

The FERC can take other steps to encourage the construction of additional transmission facilities. The most important of these additional measures is to raise the allowed rate of return for transmission investment to a level that encourages investors to dedicate capital to transmission projects. The shift to market-based rates has caused the returns on generation investment to become far greater than the returns on transmission investment. The disparity has resulted in a substantial increase in generation investment, while transmission investment has languished. The Commission's statements in Order No. 2000 that it will permit incentive rates for members of RTOs have not been sufficient to stimulate new investment. This is largely because the Commission has not yet demonstrated a commitment to actually increase rates of return on transmission, and some segments of the industry have short-sightedly opposed such increases. The Commission can have a substantial impact on transmission investment if it adopts more clear policies with respect to returns on transmission investment.

3. IF FERC HAS THE AUTHORITY TO ESTABLISH AND ENFORCE RELIABILITY STANDARDS, MAY FERC DELEGATE SUCH AUTHORITY TO A SELF-REGULATING RELIABILITY ORGANIZATION? SHOULD IT DO SO?

The FERC does not have clear authority under the Federal Power Act to establish and enforce reliability standards. The FERC has limited authority under Section 207 of the Federal Power Act to determine the "proper, adequate or sufficient service to be furnished" in response to a complaint by a State commission. However, the Federal Power Act does not explicitly give the Commission authority to take action

with respect to reliability *sua sponte,* and it is not clear whether authority to address reliability concerns is implicit in other sections of the Act.

Regardless of whether the Federal Power Act gives the Commission the authority to establish and enforce reliability standards, the Commission should strongly encourage Regional Transmission Organizations ("RTOs") to establish and enforce reliability standards. Transmission owners may voluntarily enter into agreements with RTOs pursuant to which the owners give to the RTOs the authority to establish and enforce reliability standards. This "voluntary" grant of authority over matters that otherwise would be within the discretion of the transmission owners is similar to the voluntary grant of authority that transmission owners have given to the NERC. It is unlikely that transmission owners would resist delegating responsibility for reliability matters to the RTOs, but this possibility could be avoided if the FERC were to condition other benefits, such as eligibility for incentive ratemaking, on whether the transmission owner gives the RTO responsibility for reliability.

4. ARE THERE ELEMENTS IN CECA OR OTHER ELECTRIC RELIABILITY LEGISLATIVE LANGUAGE WHICH CAN, WITHOUT MODIFICATION, BE USED IN A RULEMAKING?

As noted in response to Question 3, above, the FERC's authority to establish mandatory reliability standards is unclear. Therefore, it would not be advisable to adopt provisions of CECA in a rulemaking that imposes mandatory reliability standards. Instead, the FERC should use other means to enhance reliability, as explained elsewhere in these Comments.

5. WHAT SHOULD THE RELATIONSHIP BE BETWEEN RTOS, AS ADVANCED IN ORDER NO. 2000, AND AN ELECTRIC RELIABILITY ORGANIZATION AS PROPOSED IN CECA?

The RTOs should take over the functions of the Regional Reliability Organizations ("RROs"). The integration of the transmission reliability function with the transmission access function should result in an improvement in both functions because conflicts between the two functions can be resolved more expeditiously. In addition, if the RTOs become responsible for reliability, they will be in a better position to enforce the reliability standards. Finally, integration of reliability and access functions within the RTOs will eliminate duplication of efforts, which should result in lower expense to transmission customers.

6. HOW SHOULD THE RESPONSIBILITIES AND ROLES OF FERC AND THE STATES BE ADDRESSED IN A RULEMAKING?

If a determination is made that national standards should be adopted with respect to reliability, those standards should be adopted pursuant to legislation rather than pursuant to a rulemaking. As noted above, the scope of the FERC's authority to establish reliability standards is not clear. The passage of reliability legislation would moot the issue of whether the FERC has the authority to establish standards.

If legislation related to reliability is passed it should include the transfer of siting authority with respect to transmission facilities from State control to the control of the FERC. The FERC already has siting authority with respect to gas pipelines, pursuant to Section 7 of the Natural Gas Act. If the Commission were to have similar authority over the siting of transmission facilities, it would be able to evaluate transmission construction needs from a regional perspective instead of from a local perspective, as is

currently the case. Shifting siting authority from the states to the FERC is a critical aspect of the regionalization of transmission service. Federal siting authority, combined with the elimination of license plate rates as discussed above, would have a significant impact on the construction of the transmission facilities that are necessary to maintain the reliability of the bulk power delivery system.

7. HOW COULD IMPLEMENTATION OF MANDATORY RELIABILITY STANDARDS BE COORDINATED WITH CANADA AND MEXICO?

The FERC also should encourage RTOs to address the coordination of reliability issues with Canada and Mexico in the same way that it is encouraging RTOs to address issues at the "seams" between RTOs. This task may be less complicated than it first appears. NERC includes most of the Canadian grid, and some Canadian utilities are considering joining RTOs. A framework for coordination with Canada therefore already exists. Similar efforts should be made by the RTOs that contain transmission facilities that interconnect with Mexico.

III. CONCLUSION

The current practice of establishing voluntary reliability standards should not be modified. If any change is made, it should be done through modifications to the Federal Power Act rather than through a rulemaking by the FERC since the FERC's authority with respect to reliability matters is not clear. The Department of Energy should encourage the FERC to eliminate the disincentives to the construction of transmission

service, and in particular to mandate the replacement of license plate pricing by postage stamp pricing for RTOs.

Respectfully submitted,

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